2Q17 Conference Call Transcript – Q&A

Operator

Ladies and gentlemen, we will now begin our Q&A session. Our first question comes from Mr. Gustavo Schroden – Bank of America.

Gustavo Schroden (Bank of America Merrill Lynch)

Good morning, everyone. Thanks for the opportunity. I'll ask you two questions. The first one is to discuss the health loss ratio. Mainly because it had been relatively resilient, especially if we take into account the adverse scenario, the weak economy, the high unemployment rate and companies closing. So we understand the outcome of the initiatives you've been launching, they have been successful in recent quarters, but the point is that the health loss ratio increased a lot this quarter. I think if we had seen a smaller increase, it would be even expected, but I think it came a bit out of the expectations we had. So if you could explore what happened this quarter, when it was way higher than expectations, at least ours, and explore a bit if it was a one-time thing or a set of factors. That is the first question, then I'll ask the second one.

Maurício Lopes (Vice President of Health and Dental)

Gustavo, this is Maurício. Thanks for the question. Our perception is that we had the effect of the characteristic seasonality of the quarter and I understand your opinion that it was perhaps a bit stronger than your expectation, but the management's view is that it's nothing out of control. There was the end of the cycle of readjustments, which happens in the quarter, we're in the end of the annual cycle, and June was the last month affected by the readjustment in the large portfolios. Seasonality, notably with an increase in infectious diseases, in April and May, produced bad results, apart from a calendar adjustment which may occur between days in the end of the quarter. But still, if you look not only at the quarter, but at the first half of the year as a whole, we had our second best semester since 2012, i.e. it was a very good first quarter, a second quarter worse than what we imagined, but when you compare to the second quarter of 2016, if you remember the call of the second quarter of 2016, we had very low health and dental loss ratio in that quarter, it was even surprising, so the comparison is a bit hard here. As I always suggest, we should look more at the film than at the picture. The semester was good, it's the second best since 2012 and the trend in the portfolio, in the last several quarters, continues to be of loss ratio stability, a slight decrease, and membership growth. So the management believes we are facing a one-off issue.

Gustavo Schroden (Bank of America Merrill Lynch)

Let me just follow-up on that. I understand the issue of the semester and looking at the movie makes perfect sense, the second quarter of 2016, as you put it, was perhaps one of the best second quarters you have ever reported, so I think there's also a question of hard comp here, but the thing is that if we look at 2015 as well, I still think that the loss ratio is very high. Always looking at second quarters, the ones we know are usually the worst, it came even higher than your 2015 record, so that's what I wanted to try to understand. If I understand what you are saying, you had the issue of seasonality, but did you have any specific issues which made this quarter worse than the other second quarters in the last two years? Should we read it that way?

Maurício Lopes (Vice President of Health and Dental)

Yes, like I said, the hard comp of 2016 indeed messes up the comparison, and you agree with that on your end. I think the main thing is that there may be a set of issues here which, this time around, brought a worse result to the quarter: being it either that the end of the cycle was more abrupt, in the sense that, considering the readjustments applied for the year, notably 12 months ago, the payments in this particular quarter didn't follow until the end of the cycle, or that we had a higher level of claims in a particular day of the quarter and every day here means a lot of money, and/or we had this seasonality effect stemming from the infectious diseases in these two months I mentioned. This set of things may have led to a worse quarter. But when you look at the dynamics of the portfolio, when you look at the fundamentals of the portfolio, regardless of the metric being followed by the management, we see no red flags, on the contrary, our initiatives are being rolled out, the ones which were already active, and there is a new set of initiatives being developed for some quarters now and they should produce results, if it happens in the same way as previous initiatives, over the course of time. The dynamics of the commercial area remain adjusted, it has shown great competence in bringing new lives and the internal retention cells are working at full steam. We do not have, as I said, either in terms of claims and premiums, or in terms of retention and new additions, any indication of a structural deterioration of the portfolio. It's only a conjuncture; we are not concerned by the matter.

Gustavo Schroden (Bank of America Merrill Lynch)

That's great, thank you. Moving on, still on the same topic, but now looking ahead, actually you've already anticipated what to expect in the next quarters. You've recently concluded the price readjustment cycle and, in this sense, I would like to understand if you think the readjustments plus the continuity of initiatives can lead us to expect a better evolution of the loss ratio in the third and fourth quarters, which are usually better? Obviously I'm making year-on-year comparisons, i.e. the third quarter of this year compared to the third quarter of last year and so forth. So, do you think the price increase will be enough to offset it? Because when we look at the number of lives, it's a bit pressured, dental is holding up, but, apart from ASO, if we look at the other portfolios, the number of lives is pressured. So, should we expect the price increase and the initiatives being carried out to be enough for you to keep showing a resilient loss ratio, as we've seen in the last quarters; and even if there is an increase, it would be lower than what we've seen now? Should we expect a better loss ratio dynamic in the third and fourth quarters?

Maurício Lopes (Vice President of Health and Dental)

We don't make forward projections, so I'll try to answer in a way that makes sense to you, even though without projections. The after-sales teams were able to place, to fit, with great competence, the percentage of readjustment that they found adequate to the portfolios. The after-sales teams do not feel that we have agreed on lower readjustments than the ones we wished, so I think that is the first important aspect to consider. We don't feel we underachieved, on the contrary, we feel we've achieved the target set by the after-sales team. The second point is the seasonality of the portfolio, which is very significant and there is no reason to believe, considering the size of SulAmérica's portfolio, that we will experience some dysfunction in the seasonality of cycles that we have always had. In the last 24 months, a little more than that, we've been trying to soften the seasonality a little bit; this relates to the calendar issues we discussed in the past. We've been putting a lot of effort on that. But that does not at all remove the seasonal characteristic from the portfolio. So in your modeling, I think you have to continue to consider seasonality a relevant aspect in your results projections. I wanted to make an additional comment that I think is important: you set the ASO apart from the risk product. I would not do that. My perception of the ASO product is that it's indeed a market trend. Just as it has been in several other countries, remaining the strongest product among the new clients. And we've been strongly structuring ourselves to have a greater presence in the ASO channel. The amount of investments made by the operations and after-sales teams to provide quality service in the ASO segment is substantial. I think that when we look at the total number of beneficiaries, more and more we have to look at it considering that the ASO product brings expertise and bargaining power to the company, it composes the product portfolio, it allows for regional expansion. So it is a relevant product that we consider a lot in the company, not only when counting the number of lives, but as a general statement for the quality of operation that we have.

Gustavo Schroden (Bank of America Merrill Lynch)

No, no. The explanations are clear and I took note of your observation regarding the ASO, thank you.

Operator

Our next question comes from Thiago Kapulskis – BTG Pactual.

Thiago Kapulskis (BTG Pactual)

Good morning, Gabriel, Arthur, Maurício. Good morning, everyone, thank you for the opportunity to ask a question. I have two questions: the first regarding health and the second regarding auto. In health, in spite of all these discussions regarding the loss ratio, we still have seen you outperform in terms of membership. I think it was another quarter in which you posted membership increase, albeit little, but the market as whole is shrinking. My question is if you think you can sustain this trend in the number of members and I would also like to understand the reasons behind it, because although we see the market shrinking, obviously we could have some other player which could capture the lives from companies which are going broke, that sort of thing. What do you think is your difference and what can make this trend continue? And my second question is related to the auto segment: we have already seen the loss ratio, even though still worse year-over-year, it already showed a slowdown this quarter. And we also saw the biggest player in the industry already able to show improvement in the loss ratio. The question is whether you are seeing an improvement trend and if, in the next quarter, we can perhaps see the loss ratio improve year-over-year. Thank you.

Eduardo Dal Ri (Vice President of Auto and Massified)

Thank you, Thiago, it's Eduardo speaking, I'll start answering the auto question and then will hand over the floor to Maurício. Of course, we are very happy with the trend, with what is happening in the auto segment now, naturally we're seeing just the first numbers. Yes, we do believe in this improvement, we are working to have this improvement as soon as possible. This has been possible because, as I've been saying, I even mentioned it the last call, we've adapted or revamped our underwriting, making use of even unorthodox measures of risk acceptance in the market, we even ceased to accept policies in regions with high levels of theft and robbery that were traditionally accepted, among others. And also, as you've seen and it gets clearer in the final months of this quarter, there is the increase in average premium. This, of course, has a short-term side effect on production, as you've seen, but we believe that we, among a few other players which have already made this move to adapt both to this risk reality, that we believe may last for a long time, and the interest rate reduction, we believe that our average premium, as I said, is growing well, is very adapted to this new risk and interest rate environment. We believe that the market, in a short-term, will also follow this dynamic and then, of course, as we have seen in other cycles, production returns. So, yes, we believe in this improvement, we can have monthly, quarterly fluctuations, but we believe this dynamic has come to stay, thanks to exclusive, particular initiatives carried out by SulAmérica, together with price increase movements by the market as well.

Maurício Lopes (Vice President of Health and Dental)

Thiago, it's Maurício. I'm going to continue from this point onwards, okay? Moving to the health segment, and then if you have follow-up questions, Edu is here by my side. What we are seeing in health and dental is that sale dynamics are holding up very well in 2017. No indicator shows any sign of deterioration. More than that, some changes made within our structure bring enough assertiveness to the sales being made in the regions we want. The providers' area, for example, was revamped several months ago. Today we have local accreditation teams in regions where we need much more assertiveness than before, we changed the dynamics of centralization versus decentralization of accreditation, changed the profile of some of the local teams; so, we made several new locations available to the sales teams, regions we previously didn't consider. In a regional portfolio analysis, we've taken out regions which were not very profitable, so now we're selling more in the regions we want. We have also changed the sales profile a bit, focusing on smaller companies which are more profitable; this is not recent, we have been doing it for at least 12 months. And we have done it quite diligently among our distribution teams. I think an additional point that is always worth mentioning, which is something less visible to you: in some portfolios, we have already seen, following the unemployment trajectory in the country, a trend of organic improvement in the net additions of existing contracts. This means that today we have portfolios which were deteriorating pretty quickly because of unemployment and now are already changing the trend; and this is very good. That is, this is what will bring, tends to bring more stability to the portfolios over the next few months. So, in short, the trend we have seen in the past, regarding sales, is of good performance, good regions, well focused portfolios and unemployment with some expectation of improvement for us in the medium term.

Thiago Kapulskis (BTG Pactual)

Both answers are very clear, thank you.

Operator

Our next question comes from Eduardo Nishio – Banco Plural.

Eduardo Nishio (Brasil Plural)

Good morning, everyone, thank you for the opportunity. I also have two questions, one in health and the other in auto. In health: if you could elaborate a little more on these, let's say, one-off aspects in the quarter and how will they affect margins in the coming quarters. If you could talk a little bit more about these infectious diseases, if you think the dynamics will improve in the coming quarters. Regarding this mismatch issue, if price readjustments will address the matter, in relation to the calendar days. And also, looking at the earnings release, you talked a little bit about frequency, that you've seen increased frequency, so if you could elaborate a bit more on frequency, and if this frequency should, in theory, cool down in the coming months. That is the first question. The second question is in auto: I would like you to explain a little more, you who are in the operation, why there is this a difference between Rio and São Paulo in terms of thefts and robberies. I think in Rio it's kind of clear that you have a public safety problem, but you had a relevant increase of 20%, 30% in auto theft and robbery. And in São Paulo, you have the opposite situation, there's been a decrease of 14%. If you could comment on that, what you've been seeing, the reasons behind it and how it should evolve in the coming months and quarters. I understand that in Rio de Janeiro you have the military coming in. Have you already seen some decrease in thefts and robberies? Thank you very much.

Eduardo Dal Ri (Vice President of Auto and Massified)

Eduardo, I'll start. Your namesake will start with the auto question. It's a good question because we even make a comparison between the two states, where we have good productions, of course we have more in Rio, given our tradition, and they are really following different trends. While in São Paulo, albeit a small reduction, figures are decreasing in relation to the last two years, the total theft and robbery figures, in absolute terms; in Rio de Janeiro, in a more acute and opposite trajectory, it has been growing around 30% year-over-year and if I consider the last two, three years, thefts and robberies have easily grown 20% per year. It is easy to understand: firstly because São Paulo was the first state, in spite of the federal bill which was still being drafted at the time, the so-called "dismantling law", São Paulo moved ahead and created a state law, so it began this movement not only in terms of legislation, but also regarding the local state traffic department (DETRAN) regulations, equipping the police, giving it all the tools needed for the correct discernment between good dismantling shops, legally authorized vehicle recycling companies, and the illegal ones which basically dismantle cars originated from theft and robbery. This was very preponderant, it happened there in the beginning of 2015 and has been sustained thanks, I think, to the economy of São Paulo, which suffers, of course, with the national economy, but the police are still acting enough to fight against theft and robbery, the closing of these illegal dismantling shops has been constant. So São Paulo is a great example, and perhaps one of the only ones that we have in Brazil, for now, on this issue. Rio de Janeiro, on the other hand, is going in the opposite direction. I think the main reason is the economic situation. We have noticed occurrences not only related to the traditional thief who engages in thefts and robberies, but also some of the people who were mostly involved in drug dealing are also migrating, perhaps because of a crisis, to theft and robbery. This caused the indicators I've mentioned to reach peaks of 30%, 40% growth year-over-year, comparing with the same month last year. And Rio de Janeiro has not yet been able to effectively, despite being under the federal dismantling law, and now the whole country is subject to this law, regulate it and put into practice, through actions of the police itself, basically due to the budget crisis they are facing. They have not been able to repress these illegal dismantling shops. So, basically, the big difference is a bit economic, but also related to effectively putting the dismantling law into practice, so there we have the difference between São Paulo and Rio de Janeiro.

Eduardo Nishio (Brasil Plural)

The military change a bit this scenario in Rio, don't they?

Eduardo Dal Ri (Vice President of Auto and Massified)

That is what we hope for. What I can tell you is that the first weekend with the army on the street was very good but it means nothing, this print means nothing. We think this will make a difference if the army acts in an assertive way, if the public security in Rio de Janeiro improves, the ratios will naturally improve although we have no forethoughts about that.

Maurício Lopes (Vice President of Health and Dental)

Gustavo, this is Maurício. Thanks for the question. Well, let's see what we had this quarter: a very marked seasonality. In fact, in some regions of the country contagious diseases and the respiratory issue were very strong. Just to give you an example, some pediatric hospitals in São Paulo could not handle the volume of clients in those months. Dry and cold weather and children very close to each other naturally lead to a higher contamination. This penalized us in terms of results. Regarding the calendar effect, if we move a day from the first quarter to the second quarter, or vice versa, it means a displacement of 50-60 million reais. So hypothetically, if you took a day from the first quarter and added a day to the second quarter, the comparison between them becomes bad since you will take 60 from one and put 60 on the other, then the gross difference will be 120. This could have led to this difference in the loss ratio. Due to that, I think it's better to look at the movie is rather than the picture. It is better to look at the half year rather than at the quarter. And this is not a new topic, I say it repeatedly. Either when the quarter is good or bad, I always alert to this fact. Then, I believe the mix of these 3 things leads, naturally, to a potential deterioration of the quarter. But, again, being careful with the picture and looking at the whole movie, the movie is good. It is our second best first half in the last six years. And I think this fact has always to be underlined, because it brings a little bit more vision, better than the quarter view would bring to us.

Eduardo Nishio (Banco Plural Brasil)

No, it is perfect. Regarding the frequency, was it only the contagious diseases that caused the frequency increase or did you have any kind of moral hazard? Was there a stronger frequency? Looking at the individual portfolio, you see a relevant increase in the loss ratio.

Maurício Lopes (Vice President of Health and Dental)

In a portfolio that has higher churn, the frequency is higher, certainly, but, excluding respiratory and infectious issues, we didn't see anything relevant. Frequency increased as a whole in the quarter and that is due to the medical inflation in the portfolios, among other factors. It is the health dynamics in Brazil. Setting the respiratory issue apart, there is nothing like "look, this is a problem; it has to be worked on". On the contrary, all the actions that we have in course, when we look at the effect of the quarter and at the initiatives that are in place, there is no adjustment to be made. The feeling we have is that all the initiatives are well addressed, well worked, there was nothing that had to be recalibrated this quarter. Obviously, if, subsequently, we see deterioration in the quarters, we will have to review the actions and recalibrate them. But, as far as we can see today, there is no change in cost or correction that needs to be done. And more than that, the price readjustments placed by the after-sales team, both dental and health, are very adherent to what we imagined they would be, to what we had planned. So, up to here, there is no correction of route.

Eduardo Nishio (Banco Plural Brasil)

Ok, thank you.

Operator

Our next question comes from Mr. Rafael Frade – Bradesco

Rafael Frade (Bradesco)

Good morning everyone. Talking about health, I wanted to reinforce and understand a little bit better the loss ratio issue, specifically in the individual portfolio. As Maurício pointed well, despite the hard comparison in 2015, 2016, the first half was very good overall, but I think that the individual is an exception. I think it is the biggest loss ratio you've ever presented for this portfolio. So, could you comment a bit on this portfolio? And the second question: Maurício has mentioned about the good performance of new sales and I wanted to know if you could comment on this movement, maybe in the half year. What caught my attention was that we heard about some relatively big contracts that you could be closing in the first half, and when we look at the beneficiaries, they remained reasonably stable. I would like to understand if there were major movements in the quarter.

Maurício Lopes (Vice President of Health and Dental)

Rafael, thank you for your question, this is Maurício. The individual loss ratio is getting more and more volatile as the portfolio decreases. It reached around 170 thousand lives with a steeper downward trend. So we should expect some good quarters and some bad quarters. And this quarter specifically, I think all the effects we talked about do apply to the individual portfolio. And I think there is an aggravating factor here: we had a strong churn which naturally led to some deterioration, which is not permanent; once this runs off, the portfolio will get on track, so it has the run-off effect this quarter. Just to remember, this portfolio continues to be the main focus of our health and claims management actions. This is the priority portfolio. We have seen a very big adherence to the programs in this portfolio, despite the volatility, we have seen a greater acceptance of the beneficiaries in all programs, both in new programs such as oral & maxillofacial or rheumatoid arthritis, as well as older programs focused on diabetes and heart diseases - the most frequent chronic diseases. We have also some pilots for active aging programs which have shown very good results, but in an ever smaller portfolio and this decreasing portfolio brings this complication of volatility. So even achieving good results in the portfolio, individually, considering each of the members, we have fewer members to work on overtime and, the run-off was very strong. I think that's the explanation for the portfolio as a whole. As for the movement, as I've said, we have been working in new areas and in portfolios that we have not yet explored. We have been focusing on smaller accounts in the last months and we think these smaller accounts are bringing a better profitability profile. Nothing more to comment on that. It is the regular process: it is regular market dynamics, nothing different from what we have seen in recent years. Contracts move from one side to the other, anyway, life goes on, it is business as usual.

Rafael Frade (Bradesco)

Perfect, Maurício. Let me just follow-up on the individual portfolio issue: I think the volatility issue is pretty clear as the portfolio is getting smaller. Now the concern that remains is that when we look over a longer timeframe, the last twelve months, the loss ratio is deteriorating due to the several restrictions that the individual portfolio has: it has a higher aging component and higher price increase restrictions. And finally, you have been talking about these several initiatives being put into action. The question is less about volatility, but how much do you see the risk of this portfolio, over time, converging to a loss ratio perhaps higher than 100%? How do you see it evolving?

Maurício Lopes (Vice President of Health and Dental)

I think there are two items there: regarding the individual loss ratio issue in an increasingly smaller portfolio, we should see volatility and this worsening trend that you mentioned; however, we are looking at this situation in a very bad macroeconomic cycle. As this cycle improves, you have more lives staying in the portfolio for a longer time, so you have less adverse selection. And this may lead to a change in the loss ratio profile of the portfolio. So you can see in the future this portfolio reducing its loss ratio rather than increasing it, but only time will tell us that and it will depend on the macroeconomic scenario and on our internal capability to put our claims and health management programs in place. What I have here is a strong pipeline project driven by both the operations department and business units in all portfolios, especially in the individual one. The volume of investments the company has made was not small and they were quite well structured. We are not reacting in any of the portfolios in an occasional way. We are reacting in a very structured way, with long-term focus and sustainability. So if the macroeconomic situation changes I think we have an interesting upside here. If there is no change in the macroeconomic cycle, we have all the solid projects developed by our internal departments to work on the individual loss ratio issue. I think it is worth remembering that the price increase allowed by the regulator in this portfolio, which is a function of the readjustment of large accounts and corporate contracts, has also been greater in recent years, bringing us a relief in terms of loss ratio, compared to 3, 4, 5 years ago.

Rafael Frade (Bradesco)

Understood. Perfect, Maurício. Thank you.

Operator

Our next question comes from Mr. Gustavo Lobo – J.P. Morgan

Gustavo Lobo (J.P. Morgan)

Good morning everyone. I also have two questions, changing the subject a little. I want to talk about efficiency, your administrative expenses were very low this quarter, there was a significant drop in headcount expenses; I just want to understand if this is a new baseline for next quarters, if there was anything specific, any expenses which slipped to third quarter or had been allocated in the first quarter. Then I'll ask my second question.

Arthur Farme (Vice President of Control and Investor Relations)

Lobo, this is Arthur speaking. I think you have correctly identified the downward trend of these expenses in absolute and relative terms, improving each quarter. Not talking about trends but looking at the historical figures, the past reflects the results of all initiatives to seek efficiency that the Company has implemented. This is a necessary condition in this context of decreasing interest rates we have been experiencing. This is a component of the combined ratio and is one of the elements within our reach. Despite the decrease, despite the efficiency that we are presenting, I think an important fact is that when we compare, historically, any measure of result by headcount, the Company's revenue by headcount has been improving substantially and sequentially. Well, this is an indication that the investments in technological tools that the Company has been making have allowed us to work on a higher level, as we have been operating, but maintaining a relatively stable headcount. Not only in terms of personnel, but we are also keeping a level of investment in innovation projects and operation improvements, some of them we have been talking about when we talk about business units. All that fits in this level of expense you have seen. This is maybe the first impression about your point.

Gustavo Lobo (J.P. Morgan)

Perfect, of course. And my second question is a bit more complex: we know that the decrease in interest rate and a very weak economy is a tough scenario for any insurance company. It is difficult to offset the lower financial result with the underwriting. So, we end up going through this period of transition that we are experiencing now, with more pressure on profitability. Do you have any visibility of when this transition period is going to end? When the profitability of the Company will return to a more stable level? Thank you.

Arthur Farme (Vice President of Control and Investor Relations)

I think your comment is important, but it brings an outdated aspect when you say weak economy. We are not betting on a weak economy, we are betting on the fact that the decreasing interest and inflation rates, etc., and everything you have seen, prepares ground for a strong recovery of our economy. We are talking about an emerging country, a country that cannot grow at the levels that is growing, which theoretically will not grow at these levels, and everything being done and the reactions been read in the different sectors support the impression that, from the economic point of view, the country is in a process of recovery. The quarter, particularly, and perhaps even the whole year of 2017, when we look back, can be seen as a year of transition. Of course the interest rate is dropping faster than the economy is picking up, and when this happens we lose more in the investment income than earn in revenues. There is a gigantic effort of us to keep our expenses under control, not only the administrative expenses that were the subject of your previous comment but, above all, the operating expenses. Both Mauricio and Dal Ri commented here on the efforts that we have been making in terms of claims management and Marcelo, Vice President of life and pension, is doing the same, as well Lauzana in savings bonds. A point that you have not mentioned but is also part of your question is the investment income component and, in that sense, if on the one hand we will operate, we don't know for how long, in an environment of lower interest rates, on the other hand, the recovery of the economy reflects in our revenues and will bring us a higher volume of reserves and, consequently, of assets to manage. The trade-off for now is still unfavorable, but it should not remain so, permanently. I will pass the word to Marcelo, who is right next to me, so he can comment on what we have been doing in terms of asset management, because, in the same way as claims management and administrative expenses management, both already commented here, the financial front is also fundamental. And what Marcelo and his team have been doing is extremely important for us to keep the level of our results.

Marcelo Mello (Vice President of Investments, Life and Private Pension)

Good morning, Gustavo. Well, you follow the allocation profile of the insurer's portfolio, which has the main goal of following the ALM of the companies, so this is our priority: respecting the ALM of the companies. We are aware about what we can do additionally in terms of allocation. We are very aware of the credit portfolio, which now accounts for 17% of the total portfolio. In a still conservative way from the point of view of issuances, we are tracking the most recent ones. With some we go along, with others we don't because the rates are compressed due to the demand, but we are aware and I think the idea is to improve the credit portfolio a bit. As for market risk, there is room for us to take some risk either via real or nominal interests or in arbitrage positions, but also acting very cautiously due to the most recent valuation of the assets that we have seen. So there is some room for more risk-taking, respecting the Company's ALMs, but any move that we make will be very cautious. And, eventually, when we open a risk position, we will also buy some protection, because of the level of conviction that we have for the market, at least with this scenario that we are experiencing, it is not that big to open large directional positions to an insurer without any kind of protection. So, any position opening comes with some protection to offset some loss due to any short term volatility as we saw on May 17 and 18 when there was Joesley's audio.

Gustavo Lobo (J.P. Morgan)

It is clear, thank you.

Operator

Our next question comes from Mr. Lucas Lopes, Credit Suisse.

Lucas Lopes (Credit Suisse)

Good morning everyone, thank you for the question. I would like to talk about the group plans loss ratio. I just would like focus on mix a bit. If I'm not mistaken, you have been growing significantly in SME portfolios during the last two years. So how much this mix wieht more SMEs and less large companies helps your loss ratio? Just because I think there are two ways that it can potentially positively impact your loss ratio. First, actually you've already talked about it in the previous answers, the smaller companies are more profitable and you can have higher prices, so looking at the snapshot, the SME client would have a lower loss ratio than the average client of large companies. And the second point is that when you attract new companies you also have the grace period to take into account. So please, tell us about the effect of the mix in your loss ratio.

Maurício Lopes (Vice President of Health and Dental)

Lucas, this is Maurício, thank you for your question. In fact SME has been growing in recent years and it has been very important to us. The loss ratio of the SME portfolio is naturally lower than large corporate one, as in any business; smaller customers obviously have a little more profitability than large size clients. These clients play different goals in our portfolio. What I think is worth mentioning here is the work we have been doing regarding SMEs, not only by the prospection department/commercial department, but our all internal work to improve the level of service that is provided to this customer. The SME portfolio is as good as our operational service process is efficient. And the Company has been investing in a very solid way for at least three years in how to provide service to SMEs so that it adds value to then, making then want to stay with us, not being expensive. And it's worth mentioning all the digital channels that our operational department has implemented, the SME app both for health and dental, which has countless functionalities, so small clients – any client actually, but for the small clients in particular – can solve almost all the problems they have online, not spending any time and not increasing operating costs. The referred network is very stable, the product is very well accepted, the price is very well adjusted. So, at a well-adjusted price, a stable network and a very efficient service operation process, we are losing much less contracts in the SME portfolio than we would have expected with the crisis. Price competition is strong, but the portfolio is very resilient. And we have been very willing to make this portfolio grow; this effort didn't start this year. We are betting on increasing the portfolio share in the mix for at least three years. Naturally, by increasing its share, the loss ratio of the portfolio as a whole is benefited. So your point is correct.

Lucas Lopes (Credit Suisse)

Let me just follow-up on this, regarding SME growth: is it linked to a significant grace period or do you think it is due to the fact that the SME client is generally profitable?

Maurício Lopes (Vice President of Health and Dental)

We have a provisioning system that is independent from the grace period. When we sell one SME life today, its claims will be incredible low, around 1% of loss ratio in the month, hypothetically, but we provision the steady state loss ratio for the portfolio. So the new member comes in as if it was without grace period, in a stationary process. This is a conservative way. So there isn't a positive effect coming from bigger run-on sales in SME.

Lucas Lopes (Credit Suisse)

It is clear, Maurício. Thank you.

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